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IN THE

Supreme Court of the United States

October Term, 1930.

DAVID BURNET, Commissioner of Internal Revenue,
Petitioner,

vs.

NIAGARA FALLS BREWING COMPANY, *et al.*,
Respondents.

No. 61.

RESPONDENTS' BRIEF.

BASIL ROBILLARD,
Counsel for Respondents,
425-443 Gluck Building,
Niagara Falls, N. Y.

BATAVIA TIMES, LAW PRINTERS,
BATAVIA, N. Y.

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RESPONDENTS' BRIEF.

Opinions Below.

The Board of Tax Appeals (R. 25-35), 13 B. T. A., 1040.

Circuit Court of Appeals (R. 46-50), 38 F. (2nd) 217.

Necessary Additional Statement of Case.

The buildings and equipment of Taxpayer upon which the obsolescence deduction was taken, are not available or practicable for use in any business except the manufacture of spirituous and malt liquors, which has been prohibited. (R. 7 §9 [o]; R. 22 §§9, 13; R. 30.)

The depreciated cost of the land, buildings and equipment on December 31st, 1917, was (R. 27)		$477,054.60
This depreciated cost was the actual value of the assets on that date. (R. 28.)		
The Taxpayer took obsolescence deduction for 1918 thereon of	$110,047.52	
and for 1919 of	57,139.99	$167,187.51
The regular depreciation for the two years as approved by the Commissioner was	30,750.01	$197,937.52
The book value on December 31, 1919, after the depreciation and obsolescence had been taken was therefore		$279,117.08
The actual value of the assets during the years 1918 and 1919 (R. 32, 33) was		80,475.00
or		$198,642.08

less than the book value thereof after the deduction for obsolescence had been made. (R. 32, 33.) This reduction in value was due to prohibition legislation. (R. 33.) The city assessments of the property were substantially reduced solely on account of the effect of prohibition upon the property. (R. 31.)

Contrary to the Commissioner's contention at pages 6, 8 and 14 of his brief, there are findings (R. 28, 29) that the officers, directors and stockholders of the respondent

during 1917, 1918, and 1919 foresaw that the property would diminish in value by reason of imminent prohibition. The evidentiary facts upon which the findings were made were stipulated in the trial court. The Commissioner's counsel have changed, and the misapprehension of present counsel is obviously due to unfamiliarity with this stipulation, which is annexed to this brief as Appendix "A." The facts showing foreknowledge and anticipation of loss through prohibition appear at paragraphs 11-29 of it (pp. 21-30 *infra*). Moreover, it is found that the obsolescence deductions were based upon the sale by a similar company of its assets for less than book value after a much greater obsolescence deduction. (R. 29.)

The respondent abandoned the business of making beer in 1919. (R. 30.) The plant was located in an industrial zone under the city zoning law. (R. 30.) The buildings could not be used for any other purpose than the manufacture and sale of malt and spirituous liquors, which has been prohibited. (Petition, §9, par. [o], R. 7; Answer, §§9, 13, R. 22.) Extensive efforts to convert the premises and machinery for other manufacturing purposes were unavailing (R. 30), and the machinery could not be removed from the building without dismantling the machinery and tearing out a side of the building. (R. 30.)

Respondent's sales of beer diminished 15.8% from 1917 to 1918, and 40.9% from 1918 to 1919 (R. 30) due to war time prohibition, and from 1918 to 1919 its sales of cereal beverage decreased 97.5% (R. 30).

Respondent's best efforts to sell the premises resulted in no offer higher than $35,000 (R. 31). The highest rental

it could obtain for the entire plant was $5,000 a year, net (R. 32).

These findings conclusively show that the respondent must have known that its business and plant would become obsolete and of greatly reduced value when prohibition became completely effective January 1st, 1920, and as it became partly effective during the years 1918 and 1919.

Summary of Argument.

The tangible business property used in brewing, like any other business equipment, may be subject to obsolescence and the basis of an obsolescence deduction in computing taxable income, although intangibles such as good will may not. Wartime prohibition and national prohibition caused an obsolescence of this brewing equipment. The Commissioner exceeded his lawful powers when by regulation he attempted to condition the obsolescence deduction upon the immediate abandonment of the equipment. The taxpayer satisfied even this regulation when it abandoned the brewing of beer but continued to use the equipment to produce a drink resembling beer neither in effect, taste nor popular demand but in appearance only. The total abandonment of part of one building and the abandonment of 84% of the use of another were sufficient to satisfy any interpretation of the regulation as to these assets. There was an actual realized loss upon the equipment; the abandonment of the brewing business closed the transaction and the owner should not be compelled to pay income and profits tax upon that part of its income represented by this loss.

ARGUMENT

POINT I.

Brewery Tangibles may be the subject of deduction for obsolescence in computing income tax.

The statute is Section 234 (a) of the Income Tax Act of 1918:

> "Sec. 234. (a) That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:
>
> * * * * * * *
>
> (4) Losses sustained during the taxable year and not compensated for by insurance or otherwise;
>
> * * * * * * *
>
> (7) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence;"

The Board of Tax Appeals found every necessary fact to establish the right to an obsolescence deduction upon these tangibles, viz., the obsolescence, the cause of obsolescence, the amount thereof (R. 33), the depreciated book cost of the assets on March 1st, 1913, and the value of them on that date (R. 31, 32), the depreciated cost of them at the commencement of the obsolescence period and their value on that date (R. 27, 28), the salvage value at the end of the obsolescence period (R. 33), and the fact that the taxpayer was aware of the obsolescence during the period and prior to it (R. 28).

The taxpayer did not seek any deduction on account of obsolescence of good will or any other inherent element of its business discontinued by prohibition. The deduction was limited to obsolescence or loss of the tangible equipment with which it did the work which was ended by prohibition (R. 33)—its buildings and machinery.

The decision in *Clarke vs. Haberle Crystal Springs Brewing Company*, 280 U. S., 384, does not apply to this case until expanded to hold that the tools of brewing are so attainted by their use that the loss to the owner from obsolescence of them is not cognizable under the tax law. The Eighteenth Amendment to the Constitution prohibits the business but contains no intimation that the tools of the business are forfeit. It was certain that the equipment would become obsolete when prohibition became effective January 16th, 1920.

Obsolescence of equipment is frequently due to the progress in an art. Here it is due to progress out of the art through national legislation. The statutory permission to deduct from income a reasonable allowance for the obsolescence of these tools should be vouchsafed to the brewer as to the miner, the tobacconist, or any other producer.

> "There is nothing to suggest that the word 'property' is used in any restricted sense." said this Court of the same phrase in the prior act.
>
> *Lynch vs. Alworth-Stephens Co.*, 267 U. S., 364, 369.

Examination of the congressional history of the Act shows no contrary intention but only that the obsolescence deduction should be of general application.[1]

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1. 65th Congress, Bill H. R. 12863, House Report: H. Doc., Vol. 114, No. 1267, Serial 7444, in which the bill as reported to the House read, Sec. 234 (7): "A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, but in the case of a foreign corporation only as to property within the United States."

The Senate amendment, No. 147, Sen. Doc., 310, Vol. 4, Serial 7460, read: "A reasonable allowance for the depreciation of property used in the trade or business."

The Conference Committee in H. R. 1037, Vol. 1, Serial 7454, recommended: "That the House recede from its disagreement to the amendment of the Senate No. 147 and agree to the same with an amendment as follows: 'Omit the matter inserted by amendment and reinsert the matter stricken out by said amendment, and on Page 37, line 24 of the bill, after "business" insert a comma and the following "including a reasonable allowance for obsolescence"; and the Senate agree to the same.'"

Mr. Kitchen, Chairman of the Conference Committee, reported for it, C. R., Vol. 67, p. 2991, on Amendment No. 147:

"The House Bill provided that in determining net income a reasonable allowance shall be made for exhaustion, wear and tear of the property used in the trade or business. The Senate amendment provides that a reasonable allowance shall be made in computing net income for the depreciation of property used in the trade or business. The House receded with an amendment providing that in computing net income a reasonable allowance shall be made for the exhaustion, wear and tear of the property used in the trade or business, including a reasonable allowance for obsolescence."

An examination of the congressional history of the Eighteenth Amendment[2] reveals no congressional intention that brewers should be denied the tax privileges of other citizens.

The decision in *Renzichausen vs. Lucas*, 280 U. S., 387, does not determine the question. There the taxpayer was allowed obsolescence of tangible property by the Board of Tax Appeals. This was affirmed by the Circuit Court of Appeals and upon certiorari this Court, following the Haberle case refused to permit the deduction for the value of the good will element of the very business and also refused to increase the allowance for the obsolescence of the warehouse or to apportion the obsolescence of the plant to years when the obsolescence was not to be anticipated.

V. Loewers Gambrinus Brewery Co. v. Anderson, 42 F. (2nd), 216, is obviously a decision of attempted conformity without any consideration of the essential difference between the good will as part and parcel of the very business (*Red Wing Malting Co. vs. Willcutts*, 15 F. (2) 623, 626) and the tools used in the business. The writ of limited certiorari already granted indicates that the Court has this view of that decision (No. 352 October Term).

In *National Industrial Alcohol Company vs. Commissioner*, 38 F. (2d) 718 (decided Feb. 4, 1930) the Court of Appeals of the District of Columbia without reference to the case at bar reached the same conclusion for the allowance of deductions on obsolescent tangible assets sustained by the opinion in the Court below in this case (R. 46-50).

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2. House Joint Resolution 84, H. Rp. No. 1493, Ser. 7110; Senate Joint Resolution 17, S. Rp. Vol. 1, No. 52, Ser. 7249; H. Rp. Vol. 1, No. 211, Ser. 7307.

POINT II.

The statute requires no abandonment of assets as a condition to an obsolescence deduction and the regulations of the department introducing such a condition precedent are void.

The statute contains no definition of the word "obsolescence." Webster's Dictionary defines it as "the state of becoming obsolete" and "obsolete" as "no longer in use; disused; neglected." Obsolescence is therefore "the state of becoming no longer in use, the state of becoming disused, or the state of becoming neglected." The Standard Dictionary defines "obsolescence" as "the condition or process of gradually falling into disuse; no longer practiced or accepted, of a discarded type or fashion, bygone, antiquated." The taxpayer's equipment in 1918 and 1919 conformed to these definitions as the findings show (R. 32, 33).

No provision of the statute requires obsolescent assets to be abandoned. The Commissioner of Internal Revenue, however, promulgated the regulation known as Article 143 of Regulations 45, as follows:

> "Loss of Useful Value.—When through some change in business conditions the usefulness in the business of some or all of the capital assets is suddenly terminated so that the taxpayer discontinues the business or discards such assets permanently from use in the business, he may claim as a loss for the year in which he takes such action the difference between the cost or the fair market value as of March 1, 1913, of any asset so discarded (less any depreciation allowances) and its salvage value remaining. This exception to the rule requiring a sale or other disposition of property in order to establish a loss requires proof of some unforeseen cause by reason of which the property must be prematurely discarded as for example, where ma-

chinery or other property must be replaced by a new invention, or where an increase in the cost of or other change in the manufacture of any product makes it necessary to abandon such manufacture to which special machinery is exclusively devoted, or where new legislation directly or indirectly makes the continued profitable use of the property impossible. This exception does not extend to a case where the useful life of property terminates solely as a result of those gradual processes for which depreciation allowances are authorized. It does not apply to inventories or to other than capital assets. The exception applies to buildings only when they are permanently abandoned or permanently devoted to a radically different use, and to machinery only when its use as such is permanently abandoned. Any loss to be deductible under this exception must be charged off on the books and fully explained in returns of income. But see articles 181-188."

This regulation adds an additional burden to the tax statute, viz.: the condition that obsolescent property must be finally abandoned as obsolete and its use terminated before obsolescence deductions will be permitted for it. The regulation mistakes *obsoleteness* for obsolescence and ignores the obvious fact that obsol*escence* frequently occurs to make an asset more obsolete, less used and more neglected without forthwith rendering it entirely obsolete, useless and fit only to be abandoned.

The right to take a reasonable deduction for obsolescence was given by the Act of February 24, 1919, Section 234 (a) (7) quoted above. Obsolete and abandoned assets had always been the subject of deduction from income under the practice and the decisions:

> "With knowledge, it must be assumed, of the established practice of the Bureau in this matter the Congress included in the deductions which might be here taken for depreciation or exhaustion, wear and tear 'a

reasonable allowance for obsolescence' (Secs. 214 (a) 8 and 234 (a) 7, Act of February 24, 1919). The language employed is significant, 'a reasonable allowance for exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence.' This language signifies that it was not the intent to add a new kind of deduction but to permit the inclusion of a different element, to wit, 'obsolescence,' in exhaustion, wear and tear. No different method of computing the deduction for obsolescence than that theretofore used in the case of exhaustion, wear and tear was prescribed, and the presumption from the language employed in permitting this deduction clearly indicates that a different method was not contemplated.

"The existence of obsolescence under the earlier Acts was recognized but, as it was held not to be included in the terms 'depreciation' or 'exhaustion, wear and tear,' a deduction on account of obsolescence was only permitted when it had ripened into obsoleteness.

"As this resulted in throwing the total deduction for obsolescence as distinguished from depreciation into one year, it frequently happened that the then income was less than the allowable deduction and the cost or March 1, 1913, value was not fully returned to the taxpayer. To relieve in a measure this situation Congress provided for the recognition of obsolescence as a progressive process as distinguished from obsoleteness which was accomplished status, but, as clearly pointed out in Sol. Op. 114, there is nothing in the Act to indicate that Congress intended that this provision should have a retroactive effect."

Matter of Great Lakes Steamers, A. R. R., 963, C. B. I-1, June, 1922, p. 161 (Committee Appeals and Reviews).

The Commissioner could not lawfully reduce the statutory right from a deduction for obsolescence to a deduction for obsoleteness conditional upon abandonment. Only the Congress could make such a limitation and it might not

delegate the power to do so. To that extent the regulation is void.

International Railway Company v. Davidson, 257 U. S., 506, 66 L. Ed. 341.
U. S. v. George, 228 U. S., 14, 15 L. Ed. 712.
Williamson v. U. S., 204 U. S., 425, 52 L. Ed. 278.
U. S. vs. 200 Barrels of Whiskey, 95 U. S., 571, 24 L. Ed. 491.
Morill v. Jones, 106 U. S., 466, 27 L. Ed. 268.
Waite v. Macey, 246 U. S., 606, 62 L. Ed. 895.
Tracy v. Swartwout, 10 Peters, 80, 9 L. Ed. 354.

The various divisions of the Board of Tax Appeals have often allowed obsolescence deductions on account of the effect of prohibition on the tangible assets of breweries. In many cases the obsolescence deduction was permitted although the assets had not been abandoned.

Manhattan Brewing Company, 6 BTA, 952.
Multibestos Company, 6 BTA, 1060.
Corsicana Gas & Electric Company, 6 BTA, 565.
J. Chr. G. Hupfel, Inc., 9 BTA, 944.
Seas Shipping Company, Inc. v. Commissioner, 16 BTA, 841.

POINT III.

The taxpayer's conduct satisfied the requirement for abandonment of assets.

The taxpayer abandoned the brewing and sale of beer, October 29, 1919 (R. 31, 34). To preserve its machinery as well as to see if the new business could be made to pay (R. 27) it then manufactured a cereal beverage which did not resemble its prior product in power, in taste or in popularity, but did resemble it in appearance. Such a course did not vitiate the abandonment of the assets for the brewing of beer. The business was a different one and the product and its market were different.

If the Commissioner is right that it is necessary to close the plant and shut off the machinery from any available use to constitute abandonment, then the closing of one-third of the area of building No. 4 (R. 31), and the surrender of 84% of the use of the east half of building No. 3 (R. 32) were an abandonment in the strictest sense. The Board of Tax Appeals found the depreciated cost and value of these buildings at the beginning and end of the obsolescence period and on March 1st, 1913 (R. 31, 32). If the continuance of only a 16% use does not satisfy the regulation, then the regulation requires obsoleteness and not obsolescence because it takes no account of the gradual cessation of the use of the apparatus rapidly becoming obsolete.

We have already pointed to the findings (R. 28, 29) and to the stipulation, Appendix "A," establishing that the taxpayer well realized in 1917, 1918 and 1919 that its business was to be ended early in 1920. This was no conjecture as in the case of *Lassen Lumber & Box Co. v. Blair*, 27 F.

(2d) 17, cited by the Commissioner. The facts were notorious. The activities of the Executive, the Congress and the States first effective August 10, 1917, in war time prohibition reducing the alcoholic content to 2¾ by weight, are set forth in the complaint (R. 3, 4, 5) and uncontroverted by the answer (R. 22, §6). It is found that the assets of the taxpayer were reduced almost $200,000 in value during the years 1918 and 1919 by the certainty of prohibition (R. 32, 33). Another local brewery took a larger deduction for obsolescence than the taxpayer did and then sold its assets for a price which showed that the deduction was too small. The findings establish that the taxpayer has more than discharged its burden of proof upon this issue.

The Commissioner's position (p. 16) that the assets "were not obsolescent but were idle simply because of decreased volume of business" is an accounting distinction entitled to no weight in the construction of this statute enacted for the benefit of all taxpayers. If ever progress made an art obsolete the progress of prohibition effected that condition for brewing. (Opinion below, R. 50.)

POINT IV.

The undisputed loss in the value of taxpayer's assets is deductible as such if the obsolescence deduction is refused.

There are ample findings to show that a loss actually occurred in 1918 in the reduction of the value of taxpayer's assets by government intervention. The amount of the loss is undisputed and the reduction in value of the assets is clearly found. The assessment of a tax upon the income of taxpayer's business should properly take the loss into account. There could be no hope of recoupment of the loss even if the taxpayer were "an incorrigible optimist." The loss was a closed transaction when the Eighteenth Amendment was presented to the States and certainly when it was ratified.

This is not a case of contract liability as in the *Lewellyn* case and the *American Code Company* case cited by the Commissioner. It is an actual loss in the tax year.

> "The statute obviously does not contemplate, and the regulations * * * forbid the deduction of losses resulting from the mere fluctuation in value of property owned by the taxpayer (citing cases), but with equal certainty they do contemplate the deduction from gross income of losses which are fixed by identifiable events such as the sale of property * * * or caused by its destruction or physical injury * * * or in the case of debts by the occurrence of such events as prevent their collection * * *"
>
> *U. S. vs. White Dental Mfg. Co.*, 274 U. S., 398.

Any regulations which limit the right to use so obvious and complete a loss in computing taxpayer's income are beyond the power of the Commissioner and unlawful under the cases which we have cited under Point II of this brief.

The case of *Dick & Bros. Brewing Co. vs. U. S.*, cited by the Commissioner involves only good will, and, so far as the opinion shows, the questions here raised were not considered.

Conclusion.

The decree of the Circuit Court of Appeals for the Second Circuit should be affirmed and the Writ dismissed.

Respectfully submitted,

BASIL ROBILLARD,
Counsel for Respondents.

Appendix "A."

STIPULATION OF FACTS.

The following facts are hereby stipulated by and between the attorney for the Taxpayer and the counsel for the solicitor for the Commissioner of Internal Revenue:

1. The Niagara Falls Brewing Company, the Taxpayer, was duly organized and incorporated under and by virtue of the laws of the State of New York February 28th, 1902, and has and at all times hereinafter had its office and place of business in Niagara Falls, New York.

2. The business of the Taxpayer prior to September 5th, 1917, the date of the incidence of the Eighteenth Amendment to the Constitution of the United States, and the acts in enforcement thereof, was the manufacture, production, sale and distribution of a malt and spirituous liquor known as beer, containing more than one-half of one per cent alcohol by volume, and the business of Taxpayer and its good will were created and conducted by the manufacture and sale of such beverage.

3. The Taxpayer upon its organization purchased the buildings and equipment of the Niagara Falls Brewing Company, a joint stock association existing in Niagara Falls, New York, and assumed the current liabilities of said association.

4. The Taxpayer thereafter built some new buildings and purchased and installed some additional machinery, fixtures and equipment, which buildings, machinery, fixtures and equipment were specially constructed, designed and adapted to the Taxpayer's business of manufacturing

beer and were not readily adaptable to other uses. This property and equipment were devoted solely to the business of Taxpayer in making beer and "Pep" beer containing less than one-half of one per cent of alcohol by volume prior to the incidence of Wartime Prohibition and the Eighteenth Amendment and statutes in enforcement thereof.

5. On February 12th, 1918, the Board of Directors of Taxpayer, upon recommendation of the stockholders of Taxpayer's meeting held on the same day, authorized the Executive Committee to investigate and create a soft-drink plant of the Taxpayer, and on June 21st, 1918, directed the execution of a contract for the purchase of soft-drink manufacturing equipment, and on or about the 1st day of July, 1918, commenced the manufacture of soft-drinks.

6. Said selling of beer and malt and spirituous liquors was discontinued because of the incidence of the Eighteenth Amendment to the Constitution of the United States and the statutes in enforcement thereof, but the making and selling of soft-drinks continued after the incidence of such constitutional amendment and such statutes, and also the making and selling of beer of alcoholic content of less than one-half of one per cent (hereafter called dealcoholized beer).

7. No part of the obsolescence or extraordinary depreciation claimed by the Taxpayer, herein questioned, was computed upon or claimed on account of the depreciation of buildings, machinery and equipment for the manufacture of soft-drinks other than dealcoholized beer.

8. The investment in equipment for the manufacture of soft-drinks other than dealcoholized beer was as follows:

	Investment	*Depreciation*
1918	$5,033.09	$ 0
1919	8,175.98	553.31
1920	9,027.54	1,448.49
1921	9,200.79	1,448.49

9. The buildings, machinery and equipment for the manufacture of beer and malt and spirituous liquors were acquired for the most part prior to March 1st, 1913, and the cost, accrued depreciation, and the depreciated cost (hereinafter called "the figures") thereof on March 1st, 1913, were:

	Cost	*Accrued Dep'n*	*Depreciated Cost*
Land	$100,000.00	$ 0	$100,000.00
Buildings	196,667.97	48,475.79	148,192.18
Machinery	71,769.68	11,111.33	60,658.35
Casks and Tanks	27,643.00	6,668.54	20,974.46
Horses, Wagons, etc.	8,988.50	948.87	8,039.63
Office Furn. & Fx.	2,238.90	302.25	1,936.65
Auto Trucks	4,900.00	703.00	4,197.00
Signs	500.00	125.00	375.00
Small Cooperage	2,576.50	x	2,576.50
Saloon Furn. & Fx.	22,852.06	6,961.52	15,890.54
Outside Property	38,128.55	x	38,128.55
TOTALS	$476,265.16	$ 75,296.30	$400,968.86

10. At December 31st, 1917, the like figures thereof were:

	Cost	*Accrued Dep'n*	*Depreciated Cost.*
Land	$100,000.00	$ 0	$100,000.00

Buildings	229,999.32	80,851.25	149,148.07
Machinery	117,618.07	23,524.58	94,083.49
Casks and Tanks	40,399.35	7,855.76	32,543.59
Horses, Wagons, etc.	8,643.50	1,391.76	7,251.74
Office Furn. & Fx.	3,091.24	878.50	2,212.74
Auto Trucks	13,073.94	5,934.10	7,139.84
Small Cooperage	18,497.78	17,595.56	902.22
Saloon Furn. & Fx.	27,758.14	19,414.98	8,343.16
Outside Property	71,457.76	1,299.84	70,157.92
TOTALS	$630,539.10	$158,746.33	$471,792.77
Less Adjustment		7,219.36	7,219.36
NET	$630,539.10	$151,526.97	$479,012.13

In arriving at these figures the Commissioner restored to surplus at December 31st, 1917, all depreciation previously disallowed by him through an adjustment:

Dr.—Depreciation Reserve	$48,881.58	
Cr.—Surplus		$48,881.58

This adjustment erroneously included disallowed depreciation not reflected in the Depreciation Reserve, all on Outside Property, viz.:

Main & Niagara Streets	$5,000.00
Michigan Street	261.83
Miscellaneous property sold in 1917	1,957.53
TOTAL	$7,219.36

This depreciation had been credited direct to Outside Property Accounts. The adjustment should have been made as follows:

Dr.—Outside Property, Main & Niagara Sts.	$5,000.00	
Dr.—Outside Property, Michigan St.	261.83	
Dr.—Profit and Loss, 1917	1,957.53	
Cr.—Surplus		$7,219.36

The correction of this error requires the following adjustment:

Dr.—Outside Property, Main & Niagara Sts.	$5,000.00	
Dr.—Outside Property, Michigan St.	261.83	
Dr.—Surplus	1,957.53	
Cr.—Depreciation Reserve		$7,219.36

After this correction the figures as at December 31st, 1917, as determined by the Commissioner and accepted by the Taxpayer are:

	Cost	*Accrued Dep'n*	*Depreciated Cost*
Land	$100,000.00	$ 0	$100,000.00
Buildings	229,999.32	80,851.25	149,148.07
Machinery	117,618.07	23,524.58	94,093.49
Casks and Tanks	40,399.35	7,855.76	32,543.59
Horses, Wagons, etc.	8,643.50	1,391.76	7,251.74
Office Furn. & Fx.	3,091.24	878.50	2,212.74
Auto Trucks	13,073.94	5,934.10	7,139.84
Small Cooperage	18,497.78	17,595.56	902.22
Saloon Furn. & Fx.	27,758.14	19,414.98	8,343.16
Outside Property	76,719.59	1,299.84	75,419.75
TOTALS	$635,800.93	$158,746.33	$477,054.60

The item of Outside Property, Main and Niagara Streets, was sold in 1918, and the cost thereof used in computing the gain or loss on the sale thereof was taken without adding thereto the said item of $5,000.00 of cost written off directly and not restored thereto as outlined above.

11. The following action was taken at a meeting of the Executive Committee of the Directors of Taxpayer held June 27th, 1917, as duly recorded in the minutes thereof:

> "The committee here talked over in general the license question and other matters pertaining to the brewing industry including the pending legislation at Washington regarding the brewing of malted liquors and future prospects if laws were enacted restricting same.
>
> "The committee also made a thorough inspection of the brewery properties including the new bottling plant which is now running in first-class condition."

12. The following action was taken at a meeting of the Executive Committee of the Directors of Taxpayer held August 29th, 1917, as duly recorded in the minutes thereof:

> "The subject of manufacturing a temperance beer in the near future was brought up and discussed without any action being taken."

13. The following action was taken at a meeting of the Executive Committee of the Directors of Taxpayer held September 5th, 1917, as duly recorded in the minutes thereof:

> "On motion duly seconded and unanimously carried it was decided to have Brewmaster Daegelow make a brew of what is generally known as Temperance Beer and have it in readiness for sale by October 1st, if possible so that some of the customers who were not granted a license could continue in business.
>
> "On motion, duly seconded and unanimously carried, the President was authorized to have special bot-

tles and labels made to use on the new product and to use his best efforts to have same here previous to Oct. 1st."

14. The following action was taken at a meeting of the Executive Committee of the Directors of Taxpayer held November 2nd, 1917, as duly recorded in the minutes thereof:

"The President informed the committee that he had met Mr. Schultz the Buffalo Brewery Architect and discussed with him the cost and details of a soft drink bottling establishment, and that a report of his findings would be submitted at a later date.

"At the suggestion of Mr. Nye, the committee here sampled the new temperance beverage 'Pep' and after drinking several glasses pronounced it very good and a correct imitation of beer without the alcohol. Mr. Nye informed the committee that the new drink would in all probability be placed on the market just previous to Thanksgiving."

15. The following action was taken at a meeting of the Executive Committee of the Directors of Taxpayer held November 23rd, 1917, as duly recorded in the minutes thereof:

"The President stated to the committee that all was in readiness to place 'Pep' on the market and that the sale of same would commence on the 28th day of November, and that he would like the committee to fix a price for bottled and in the wood.

"On motion, duly seconded and unanimously carried, the price of 'Pep' in wood was fixed at $8.00 per barrel and in bottles at $1.20 per case or 60 cents per half case.

"The President reported to the committee that he had visited the Ballantine Brewing Company's Soft Drink concern at Newark, N. J., and that he found the operation of bottling temperance drinks very simple and profitable. He further stated that he called upon Mr. Hires of the Hires Root Beer Company in New

York City who explained the root beer proposition in detail and that Mr. Hires was very anxious to have this company handle the product in a three county territory.

"On motion, duly seconded and unanimously carried, the President's report was received and filed."

16. At a regular meeting of the Board of Directors of Taxpayer held November 13th, 1917, action was taken, as in the minutes of said meeting recorded, as follows:

"On motion of Mr. Krull, seconded by Mr. Mayle, and unanimously carried, the Executive Committee were instructed to investigate the kind and cost of necessary machinery for manufacturing and bottling Hires Root Beer and other temperance beverages, and also to investigate other breweries manufacturing and bottling temperance beverages, and if they deem it advisable to proceed therewith, they be authorized to so proceed and conserve the interests of the brewing company and that they be further authorized to enter into any and all contracts necessary for such purpose."

17. The following action was taken at a meeting of the Executive Committee of the Directors of Taxpayer held November 28th, 1917, as duly recorded in the minutes thereof:

"The matter of manufacturing a line of soft drinks was thoroughly discussed and Mr. Nye informed the committee that he had been investigating the proposition to some extent and would be in a position to give some definite information on the subject very shortly.

"On motion, duly seconded and unanimously carried, the President was authorized to visit New York and Newark, N. J., in the interest of manufacturing soft drinks. * * *

"The committee here made an inspection of the premises with a view to locating a soft drink manufacturing and bottling plant."

18. The following action was taken at a meeting of the Executive Committee of the Directors of Taxpayer held December 12th, 1917, as duly recorded in the minutes thereof:

> "The President submitted a communication from the Charles E. Hires Company stating that they would like very much to have the company take action on their soft drink proposition and that they were very anxious to have the Hires Syrup in Niagara Falls at the earliest possible moment as the transportation situation looked rather dark according to reports.
>
> "On motion, duly seconded and unanimously carried, the communication was received and filed.
>
> "The President presented a letter from the United States Brewers Association calling the attention of brewers to the new law in effect January 1st, governing the manufacture of malted products.
>
> "On motion, duly seconded the communication was ordered received and filed.
>
> "A communication from Mr. C. W. Feigenspan, President of the United States Brewers Association was read, in which was stated that he expected every brewer in the United States to put forth their best efforts to fight against the proposed prohibition legislation to be enacted by the 48 states in the Union for National Prohibition.
>
> "On motion, duly seconded, the communication was ordered received and filed and the Secretary instructed to write Mr. Feigenspan to the effect that this company had faith in the cause and in him and that he had our assurance of unswerving support."

19. The following action was taken at a meeting of the Executive Committee of the Directors of Taxpayer held February 8th, 1918, as duly recorded in the minutes thereof:

> "Mr. Cohn was present and conferred with the committee and Mr. Ashton, the auditor with respect to the annual report and the matter of taxation and the amount of depreciation to be written off on buildings, machinery, etc.

"Other matters of a financial nature were brought up and discussed at some length after which an inspection of the plant and machinery was made."

20. At the annual meeting of the Stockholders of the Taxpayer held February 12th, 1918, the following action was taken, as duly recorded in the minutes thereof:

"The President of the company made a report as to the condition of the brewing business generally and as to the growing tendency of prohibition. The questions so raised by the President were discussed by the stockholders, and on motion seconded and unanimously carried, it was resolved that it is the sense of this meeting that the officers, directors and members of the Executive Committee make such investigation and take such action in respect to the installation of a plant for the manufacturing of all kinds of soft drinks as in their judgment might be necessary for the interests of this company and for the preservation of its business, and that the stockholders recommend to them the taking of such action and making of all the necessary expenditures, if in their judgment it is advisable to carry the same into effect."

21. At a regular meeting of the Board of Directors of Taxpayer held February 12th, 1918, action was taken, as in the minutes of said meeting recorded, as follows:

"The recommendation of the stockholders of the company at the meeting this day held, in respect of the investigation and installation of the soft drink proposition was discussed, and on motion seconded and unanimously carried, the Executive Committee was authorized and empowered to cause such investigation to be made, and if in their judgment it was advisable so to do, from time to time to make the necessary expenditures for the installation of a soft drink plant, upon such terms and through such medium as in their judgment it is advisable so to do."

22. The following action was taken at a meeting of the Executive Committee of the Directors of Taxpayer held

March 22nd, 1918, as duly recorded in the minutes thereof:

"The President submitted a communication from the Food Conservation Committee at Washington to the effect that beginning April 1st, 1918, only 70% of the production of April, May and June could be produced during the corresponding three months of the present year.

"On motion, same was ordered received and filed and the brewmaster instructed to observe the instructions contained therein."

23. The following action was taken at a meeting of the Executive Committee of the Directors of Taxpayer held April 22nd, 1918, as duly recorded in the the minutes thereof:

"The President submitted a proposal from Jacob House & Sons of Buffalo, N. Y., in which they agreed to furnish for use in equipping the new soft drink bottling plant, the following:

"One Big Buffalo Carbonator, capacity 250 to 300 gallons per hour, including double drum high pressure gas outfit, and ¾" block tin pipe not over eight feet in length, to connect with Crown Junior Machine, f. o. b. Niagara Falls..... $380.00

"One—No. 5 Lynn Filter complete, f. o. b. Niagara Falls, N. Y..... 235.00

"Two—Syrup Percolaters with capacity each of forty gallons filtered syrup, $32.50 each 65.00

"Two—40 gallon self drained style, stone syrup jars, $15.00 each..... 30.00

"Straight tinned outlet faucets for same, each $1.00.

"All f. o. b. Niagara Falls.

"On motion, duly seconded and unanimously carried, the President was authorized to enter into contract with Jacob House & Sons for the equipment above mentioned at the price stated.

"The President submitted a proposal from the Crown Cork & Seal Company, in which they agreed to furnish one Junior Automatic Crown Soda Machine, f. o. b. Baltimore for the sum of $1634.00.

"On motion, duly seconded and unanimously carried, the President was authorized to execute a contract with the Crown Cork & Seal Company to furnish the machine above mentioned for the sum of $1634.00."

24. By action of the Board of Directors of Taxpayer duly taken at a meeting held May 24th, 1918, as recorded in the minutes thereof, said Executive Committee was discontinued on and after June 1st, 1918, and at said meeting the following action was taken as duly recorded in the minutes thereof:

"A discussion was here had as to the advisability of this company engaging in the so-called soft drink or beverage business, and on motion of Mr. Schoellkopf, seconded by Mr. Mayle, the President of this company was authorized to negotiate with A. C. Frier of Niagara Falls, N. Y., who is engaged in the business of manufacturing, bottling and vending so-called soft drinks, to see if this company could acquire the business conducted by him, and at the same time secure his services as Superintendent of the soft drink plant."

25. At a meeting of the Board of Directors of Taxpayer held September 2nd, 1918, action was taken, as in the minutes of said meeting recorded, as follows:

"A discussion was here had as to the further continuance of the business of this company, the likelihood of prohibition, and its effect upon the property, assets and good will of the company, and the future course of the company in respect to its property and business in the event of prohibition becoming a fact.

"On motion of Mr. Schoellkopf, duly seconded by Mr. Chormann, the President was authorized and requested to appoint a committee of three for the purpose of considering the future of the company and a reorganization thereof, the President to file a list of such committee with the Secretary."

26. At a meeting of the Board of Directors of Taxpayer held November 26th, 1918, action was taken, as in the minutes of said meeting recorded, as follows:

"The President made a verbal report on the conditions relating to the brewing business in general, and stated that pursuant to the resolution adopted at the meeting September 2, 1918, directing him to appoint a committee of three for the purpose of considering the future of the company and the re-organization thereof, he had appointed Messrs. Paul A. Schoellkopf, Frederick Chormann and Rudolph V. Rose as such committee. * * * *

"On motion of Mr. Chormann, seconded by Mr. Rose, the President and auditor of this company were authorized to investigate and make a report on the question of lawful depreciation of plant, property and equipment of this company, and to make such depreciation as in their judgment, after careful investigation, is just, lawful and proper."

27. At a meeting of the Board of Directors of Taxpayer held February 5th, 1919, action was taken, as in the minutes of said meeting recorded, as follows:

"On motion of Mr. Krull, seconded by Mr. Mayle, and unanimously carried, the following resolution was adopted:

"WHEREAS, the Accounting Department of this company has after due consideration and consultation with the officers of the company, and with its counsel, made up an operating statement for the year 1918, in which charges have been made for extraordinary depreciation to that part of the plant of this company which has been acquired for and is peculiarly adapted to the use in the brewing of malt liquors, because of actual as well as obvious and impending conditions tending to render such portion of the plant of greatly decreased value, because of conditions arising during said year 1918; and

"WHEREAS, this Board has duly considered the charges to operation so made, as shown by the report submitted on this date,

"NOW, THEREFORE, BE IT RESOLVED, that the action of the accounting officers in making such charges to operations for depreciation of the tangible

property of this company, occurring through actual as well as obvious and impending conditions relating to the business of the company for the year 1918, be and the same is in all things ratified and approved, and the Accounting Department is hereby instructed permanently to enter such charges for extraordinary depreciation for the year 1918, amounting to $110,147.52, as tentatively proposed, upon the operating statement submitted to this Board."

28. At the annual meeting of the Stockholders of the Taxpayer held February 11th, 1919, the following action was taken, as duly recorded in the minutes thereof:

"On motion seconded and unanimously carried it was RESOLVED, that all acts, things and transactions of the officers, directors and members of the Executive Committee of this company, since the date of the last annual meeting to the day of the date of this meeting, including the execution and delivery of all documents, contracts, notes, papers and writings signed by them or any of them, or entered into for and on behalf of this company, as well as all salaries, disbursements and other payments of every kind and character made during such year, be and each of them is hereby specifically in all things ratified, confirmed and approved, with the same force and effect as if each and every of such acts, things and transactions had been done and performed or made upon the express instructions and directions of the stockholders in respect thereto. * * * *

"A general discussion was here had as to the condition of the business, generally, and as to the probable losses which the company might have to sustain during the year through prohibition movement, if the same became effective. The President asked for suggestions from the stockholders as to the business and affairs of the company, offered to furnish any information which any of them might request. No such request being made, or explanations desired, and there being no further business to come before the meeting, the same was, on motion, seconded and unanimously carried, adjourned."

29. The charges against earnings of the year 1918 re depreciation and obsolescence made on the books and records of the Taxpayer in determining its income as recorded and as returned to the Federal Government as the basis of determining its income and profits tax liability for that year were:

	Regular Depreciation	*Obsolescence*
Buildings	$ 4,597.63	$ 27,014.33
Machinery	5,389.93	59,430.22
Casks and Tanks	2,019.81	16,912.87
Horses, Wagons, etc	862.98	1,268.56
Office Furn. and Fx.	152.48	532.42
Autos and Trucks	2,611.26	2,204.40
Small Cooperage	650.00	2,132.71
Saloon Furn. and Fx.	833.21	522.01
Total	$17,117.30	$110,047.52

30. The like charges for the year 1919 were:

	Regular Depreciation	*Obsolescence*
Buildings	$ 5,049.28	$ 40,000.00
Machinery	5,854.02	10,000.00
Casks and Tanks	2,071.52	928.48
Office Furn. and Fx.	157.89	114.24
Auto Trucks	100.00	0
Small Cooperage	400.00	0
Saloon Furn. and Fx.	0	450.00
Outside Property	0	5,647.27
Total	$13,632.71	$ 57,139.99

31. After sundry examinations, hearings, etc., the Commissioner computed the income and profits taxes of this corporation to be:

1918	—	$ 20,975.05
1919	—	5,152.57
		$ 26,127.82

whereas the said taxes as determined by the Taxpayer were:

1918	—	$ None
1919	—	138.92
		$ 138.92

the net differences being:

1918	—	$ 20,975.05
1919	—	5,013.65
		$ 25,988.70

which the said Commissioner formally determined and assessed as such under date of November 26th, 1924, assessing same under the provisions of Section 274 (d) of the Revenue Act of 1924.

32. Notices and demand for payment of said additional assessments were thereafter received. Claim in abatement thereof, accompanied by bond, was filed on January 15th, 1925, which claim was rejected under date of August 13th, 1925, and petition to this Board duly filed.

33. In his determination of additional taxes due the Commissioner has readjusted depreciation, obsolescence, and losses as originally taken by the Taxpayer as follows:

1918	*Claimed on Original Return*	*Allowed by Commissioner*		*Difference*
Regular Depn.	$ 17,117.30	$20,552.05		3,434.75
Obsolescence	110,047.52	0	*(minus)*	*110,047.52*
Loss, Casks & Tanks	0	18,210.16		18,210.16
	127,164.82	$38,762.21	*(minus)*	*$88,402.61*
1919				
Regular Depn.	$ 13,632.71	$20,983.05		$ 7,350.34
Obsolescence	57,139.99	0	*(minus)*	*57,139.99*
	$70,772.70	$20,983.05	*(minus)*	*$49,789.65*

34. The book cost and the net depreciated book cost of the fixed assets of the Taxpayer at December 31st, 1918, and 1919 were:

	Dec. 31, 1918		*Dec. 31, 1919*	
	Book Cost	*Net Dep't'd Cost*	*Book Cost: Net*	*Dep't'd Cost*
Land	$100,000.00	$100,000.00	$100,000.00	$100,000.00
Buildings	229,999.32	108,057.31	229,999.32	63,088.03
Machinery				
Beer	131,675.21	32,500.00	134,542.63	19,966.71
Soft-drink	4,533.09	4,533.09	7,400.18	6,946.87
Casks & Tanks	40,399.35	5,000.00	40,399.35	2,000.00
Horses, Wagons, etc.	8,638.50	1,000.00	8,570.50	932.00
Office Furn. & Fx.	3,101.74	600.00	3,173.87	400.00
Auto Trucks				
Beer	15,283.85	3,000.00	15,568.60	3,284.75
Soft-drinks	500.00	500.00	775.80	675.80
Small Cooperage	2,632.71	500.00	2,232.71	100.00
Saloon Furn. & Fx.	28,383.06	100.00	28,733.06	0
Outside Property	38,128.55	38,128.55	38,147.27	32,500.00
TOTALS	$603,275.38	$293,918.95	$609,543.29	$229,814.16

34. The sales of the products of this company in the years 1912-1921, inclusive, were:

	Barrels		
		Cereal	
	Beer	*Beverage*	*Soft-drinks*
1912	33,177		
1913	37,581		
1914	32,756		
1915	30,681		
1916	38,388		
1917	37,196	16	
1918	30,204	327	$6,092.35
1919	17,823	8	22,451.35
1920	0	7,921	21,507.43
1921	0	2,852	

The sale of beer was discontinued October 29th, 1919.
The first sale of cereal beverage (dealcoholized beer) was November 27th, 1917, under the name of "Pep."
The first sale of soft-drinks was July 1st, 1918.

35. The Taxpayer under date of January 15th, 1922, leased all of its buildings, plant and equipment, including its soft-drink equipment, under a lease running for a period of three months, renewable at three month intervals at the option of the lessee, and which lease is still in operation, at an annual rental of $5,000.00 plus taxes, insurance and repairs.

36. The assessed valuation of the real property of the Taxpayer was, by action of the Assessor of the City of Niagara Falls, New York, reduced from $223,460.00 to $183,460.00 in 1918, and was further reduced in 1923 to $104,760.00.

37. The Taxpayer has duly dissolved under voluntary consent of its stockholders by certificate to such effect filed with the Secretary of State of the State of New York on December 1st, 1921, its affairs in dissolution being administered by its directors as Trustees in Dissolution pursuant to Section 220 of the General Corporation Law (now Section 105 of the Stock Corporation Law) of the State of New York.

Dated: March , 1927.

NIAGARA FALLS BREWING COMPANY,
By BASIL ROBILLARD,
Attorney.

COMMISSIONER OF INTERNAL REVENUE,
By A. W. GREGG,
Solicitor.